Report to Cabinet – 15 September 2008

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AUTUMN BUDGET STATEMENT

Summary

This paper sets out the context, at both the national and local level, within which the County Council's medium term financial plan will be framed over the next three years.

There are three critical issues facing KCC and the rest of local government at the moment:

- the totality of resources between now and 2011 that are available at a national level for our services which were set out in the Comprehensive Spending Review 2007;
- how we balance increasing demands on our services due to demographic and wider socio-economic change, government imposition of new burdens, climate and environmental change, rising customer service expectations and indeed our own aspirations for continued innovation and improvement in services at a time of nationally and locally constrained resources;
- how we respond and react to the continuing to unfold "credit crunch" and the more recent rapidly escalating rises in inflation which are now way above the target set for the Bank of England by the government.

The key conclusions from this report are:

Resources:

- the current local government finance settlement is a three year settlement lasting to 2011;
- key driver of resources for local government in total is that set out in CSR 07;
- CSR07 assumptions were set before the implications of the global "credit crunch", the slowing of the world and UK economies, the rapid escalation in commodity prices (oil, petrol, diesel, gas, electricity etc.)and the spill over into inflation more generally;
- the levels of grant for 2009-10 and 2010-11 pre-announced last year, whilst viewed as significantly constrained last year, are now to be seen as even more severely constrained, falling well short of any accepted measure of inflation and thus are real terms cuts in funding;
- the Government's announcements, at the time of writing this report, on measures to help the housing market appear to be very modest and thus have no material affect on the outlook for the housing market, the overall economy or KCC's financial planning assumptions.

The items on which KCC and partners are most concerned are:

- the overall resources available to fund service pressures (particularly demographics in elderly and disability services) and inflation;
- regional disparities, in particular flowing from the Barnett formula and other regional comparisons;
- the funding of the Growth Agenda;
- the operation of the main funding formula and its inbuilt deficiencies which fail to adequately reflect Kent's unique features (and whether those will be adequately addressed in the next formula review in 2011-12);
- the operation of Dedicated Schools Grant and its inbuilt deficiencies in terms of resource allocation and the total quantum of funding;
- the burdens imposed upon us by government without adequate recompense in terms of additional funding;
- a continued failure by government to assure us that it will fully reimburse asylum costs

Recommendations

Cabinet are asked to note:

1. The key conclusions from this report as set out in the summary.

2. KCC has developed and strengthened its policy led budgeting yet further to ensure that it optimises the allocation of constrained resources to meet local priorities

3. The financial planning risks for KCC which are set out in paragraph 92 onwards of this report

4. The proposed Medium Term Planning key milestone dates set out in Appendix 1.

Background Documents: None

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AUTUMN BUDGET STATEMENT

Introduction

1. This report is a key stage in medium term financial planning. It provides an opportunity to review both the national and local contextual issues that will shape our forward thinking for the next three years. It also gives direction to the necessary actions required to deliver the Council's policies and priorities and sets out the financial framework for the budget and medium term financial plan, which will be presented for formal agreement by Council next February.

2. In particular it looks at what resources will be available to local government from the national perspective and at how we will deliver the medium term plan in KCC within the context of the likely distribution of that total national resource to Kent over the medium term.

The Economy and Public Expenditure

3. The Budget 2008, announced on 12 March, is the most recently published document setting out the government's view of the national economic situation and the public finances. Featured, were the confirmed plans to remove the 10 pence starting rate of tax, and to cut the basic rate of income tax from 22 pence to 20 pence from April 2008 (subsequently followed by measures to try and alleviate the increased taxation for low earners that this removal of the 10p rate caused). The Chancellor affirmed that inflation was expected to be above the 2.0% target rate, with CPI falling back to 2.5% by the end of 2008 and returning to target in 2009 and beyond. The economy was expected to slow markedly with growth down from 3% in 2007 to 1.75% to 2.25% during 2008, rising to 2.25% to 2.75% in 2009 and 2.5% to 3.0% in 2010. The Chancellor will be presenting his pre-budget report in the autumn of 2008, which will provide updated forecasts of the public finances and will set the scene for the 2009 Budget.

4. It has to be said that those statements looked optimistic at the time and now look increasingly optimistic and indeed unattainable. Both the OECD and the IMF have issued recent reports pointing to a much more significant slow down in both the UK and world (especially developed) economies. The IMF report published in August for example has revised growth for the UK down to 1.4% in 2008 and 1.1% in 2009, both well below government projections. That same report noted accelerating inflation in the UK and predicted that the 2% target would be breached for an "extended period". It further went on to say that to rebalance government spending plans there would need to be sharp spending cuts or tax rises of up to 1% of GDP a year until 2013. Now the latest OECD forecast issued in September predicts growth of just 1.2% for 2008 and shrinkage in the economy for the latter two quarters of 2008-09, which meets the working definition of a recession, two quarters of negative growth.

5. The Bank of England's August Inflation Report takes a more cautious stance still on the outlook for economic growth for the UK. It assumes output is broadly flat (i.e. nil growth) for the next year with a recognition of risks on the downside that could mean a contraction in the overall economy

6. The Bank of England's Monetary Policy Committee held base rates at 5.0% in August 2008, following three separate 0.25% percentage cuts since their most recent peak in autumn 2007 at 5.75%. The Bank of England is facing a clear dilemma over future interest rates: rising and rapidly escalating consumer and retail prices well above the long run 2% target should result in a tightening of monetary policy and increases in interest rates but to

do that at a time when the economy has slowed significantly runs the risk of pushing the economy into recession.

7. The Bank of England therefore appears to be adopting a wait and see strategy hoping that the rapid escalation in prices primarily as a result of spikes in commodity prices and oil in particular will be short lived and that whilst in the short run that will mean much higher levels of inflation, these will partly self correct over the medium term as commodity prices stabilise and then tail off (as has happened with oil recently, down over 20% from its high reached in July)

8. We have also made some key assumptions on the outlook for the next Spending Review due in 2009 (SR09) and local government in particular so that we can look beyond the current financial settlement which runs to 2011.

9. The Institute for Fiscal Studies analysis of The Budget 2008 indicated that real terms cuts in forecast spending needed to grow from £4bn for the CSR07 period (3 yrs 2008-11) to £8bn for the next spending review, SR09 (2 yrs 2011-13). If we further assume the Chancellor permanently funds the whole £2.7bn per annum cost of the subsequently announced rebates to part compensate for the removal of the 10p starting rate of tax then that means £4.7bn needs to be taken out of public spending per annum to rebalance spending. That level of saving is equivalent to a 1.2% reduction per annum in real terms growth and given CSR 07 had broadly 2% real terms growth per annum that means headroom would be down to 0.8% real terms growth across the whole of the public sector.

10. At the time of writing this report the government has begun to announce measures to help the housing market.
    - A one year exemption from stamp duty for house sales up to £175,000 in value (then reverting back to the current £125,000 limit);
    - "Free" five year loans of up to 30% of a property's value for first time buyers of new homes in England;
    - Extension of powers for councils and housing associations to be able to pay off debt for homeowners who can no longer afford mortgage payments and then charge rent;
    - Shortening from 39 weeks to 13 weeks the period before Income Support for Mortgage Interest is paid;
    - Bringing forward spending from future years to encourage more social housing to be built.

11. The first measure is estimated to cost an extra £600 million and HM Treasury have not indicated how this will be funded. The remaining measures are all said to be a bringing forward of existing spending plans. Whilst this puts further spending pressure on the public finances it is a set of measures that, on top of the stamp duty holiday, will initially directly help perhaps just 16,000 households (with a further 10,000 helped to avoid repossession and 5,500 more social homes built earlier than planned. Whilst a helpful start, this has to be set in the context of the 24.4 million households in Great Britain, so the measures appear very modest.

12. The funding position is therefore bound to be tighter still. This position was all predicated on a 2008 Budget assuming growth of 2.5-3% by 2010. The International Monetary Fund thinks that UK growth more like an average of 1.25% for each of the next two years is more realistic. So that takes a further average 1.5% off long term trend growth. So that leaves minus 0.7% on average real terms growth and clearly, given spending priorities and

commitments by government to the NHS and education, that pain will not be passed on there to any significant level. Local government can therefore expect even less than that average, i.e. an even worse real terms settlement, perhaps around -2%.

13. If we assume CPI inflation in the longer run is kept to the 2% target and the GDP deflator (used for pricing government spending plans) is 2.5% by 2012-13 then that means there may be only +0.5% nominal cash per annum increases for local government in SR09. That's compared to the local government CSR 07 and 2008 grant settlement of a 3.5% increase in nominal cash terms on average (and in real terms +1% per annum).

14. In summary we can expect higher inflation, lower growth, worse public finances overall, a need for a reduction in public spending as a share of gross domestic product and probably pretty much standstill cash grants for local government which will of course be a real terms cut. No additional cash at a time of increasing demand on our services will undoubtedly mean difficult decisions lie ahead. We are assuming for KCC a cash grant increase of 1.3% in 2011-12. The reason this is higher than the expected average is that we currently pay into the damping mechanism for formula grant to the tune of nearly £12 million per annum and we would expect an element of this (assumed at 30%) to continue to unwind over time as damping is removed.

Inflation

15. Inflation is currently running at 4.4% (CPI August 2008). The trend in this figure is firmly upwards and in the short run it will continue to go higher still, primarily due to higher oil prices to work through and feed into consequential rises in the cost of road fuel, gas and electricity prices (whilst oil prices are now falling it will take time for that downward pressure to fully work through into the rest of the economy). The rate is significantly above the long run inflation target which is set at 2.0%. Similarly RPI, the inflation measure which is used for benefits indexation, is currently running at 5.0% (August 2008). The same pressures have affected RPI but there has been some downward pressure on the RPI from mortgage interest payments (excluded in CPI) which have been falling as the base rate has reduced but the benefit to consumers may be less marked because the "credit crunch" has affected the rates at which mortgage lenders are prepared to actually lend or indeed even lend at all. There will be some further downward pressure on the RPI from falling house prices (because a percentage of the average house value is used each month as a proxy for the cost of maintaining houses in their current condition). The interaction of lower interest rates and falling house prices could mean RPI and CPI cross over before the year is out (i.e. that CPI, the preferred measure, exceeds RPI, whereas we have got more used to the inverse).

16. Neither CPI or RPI may be the best rates to use when considering public sector inflation. One of the biggest difficulties in dealing with this area is to find any robust consistent method of measuring public sector inflation. The current methodology is derived from public sector outputs and has been revised many times by the Office for National statistics (ONS). The Chief Secretary to the Treasury has agreed in principle to develop a measure of public sector inflation but progress on its implementation has been slow and there has to be concern that part of the reason for delay is that if there is a measure available which demonstrably shows funding increases at a rate less than inflation that government will feel under pressure, and rightly so, to increase its funding for local government.

17. The Adam Smith Institute has previously set out an argument that shows that public sector inflation (PSI) has run at almost 5% per year since 1997. Our estimates, based on current budget data continue to be consistent with a local price inflation rate in excess of 5%.

18. We have, of course, already taken action to address some of the inflationary pressures following Cabinet on 4 August 2008. Additional inflation pressures for 2008-09 of £5.3 million were identified and we have broadly covered that pressure by allocating our £5.1 million contingency for inflation itself approved by Cabinet on 14 July (funded from the reported under spend on the 2007-08 budget). Nevertheless the inflationary pressures remain pronounced as identified in the report to Cabinet on 4 August: an additional £14.9 million in 2009-10 and a further £13.4 million between 2010 and 2012 which we are having to address as part of this budget and medium term planning round.

Government's Current Spending Plans

19. Comprehensive Spending Review 2007, published in October 2007, set out the government's spending plans for the period 2008-09 to 2010-11. This remains the prime source of funding information for local government.

20. The Budget 2008 highlighted the following:
- Measures designed to tackle child poverty through increases in Child Benefit and reform of how Housing and Council Tax Benefit operates from October 2009;
- Measures to tackle climate change including an ambition for all new public sector buildings to be zero carbon by 2018 and the publication of five year carbon budgets from 2009;
- Voluntary and statutory arrangements with energy companies to help those facing fuel poverty;
- For schools £200m of funding to be brought forward one year to 2011 to support the aim that no school should have fewer than 30 per cent of its pupils achieving 5 A*-C GCSEs, including English and Maths;
- Funding to develop technology to underpin national road pricing schemes;
- Measures to try and enhance the efficiency of PFI projects;
- An announcement of the start of a review for the value for money framework post the CSR 07 period (i.e. from 2011 onwards) which will set out further public sector efficiencies and savings (amounts to be quantified in Budget 2009).

21. So we can expect some further pressure on local government spending and very little in the way of additional resources to help fund that spending.

Comprehensive Spending Review 2007 (CSR07)

22. On 9 October 2007, HM Treasury announced the second Comprehensive Spending Review, CSR 07 (the first being in 1997). It set out what the investments and reforms initiated to date have delivered and what further steps must be taken to ensure that Britain is equipped to meet the challenges of the decade ahead.

23. The efficiency target for local government was confirmed at 3% per annum. An additional £150m was made available for supporting the efficiency programme in local government.

24. CSR 07 set out arrangements for £5 billion of specific grants to be mainstreamed (i.e. re-badged) into formula grant and into the LAA area based grant over the three year period of the CSR. This has subsequently been reflected in the three year local government finance settlement 2008-11.

25. CSR 07 also confirmed there would be a third round of Performance Reward Grant but with the inference (and since confirmed) that the PRG available will be smaller than current

levels ("at a level that maintains incentives but recognises that partnerships are now much stronger").

26. CSR 07 also confirmed that the current LABGI scheme (worth £1 billion over three years) would cease and was to be replaced with a new scheme from 2009-10 with a national budget of just £50m rising to £100m in year 2.

27. Finally CSR 07 also set out the following statement on council tax. "This will provide the resources to enable local authorities to deliver improving services while maintaining the low council tax rises of recent years, and the government expects the overall increases in council tax to be well under 5 per cent in each of the next three years".

The 'Four Block' System

28. In 2006-07, settlements began adopting a new 'four block' system for formula grant, which means that total assumed spending and formula spending shares (FSS) no longer exist.

The four blocks of the model are as follows:

i. Relative Needs Block – worked out using the Relative Needs Formulae (RNF), this is the equivalent to FSS
ii. Relative Resource Amount – takes account of different capacity to raise income for council tax (a negative amount for KCC)
iii. Central Allocation Amount – allocated on a per capita basis
iv. Floor Damping Block – to ensure that all authorities receive the minimum grant increase

29. The four block system is less transparent than the previous FSS system, and it is harder to explain to key stakeholders. This is because it is no longer possible to easily find out the total the government is prepared to support through grant and how much of this is assumed to be financed by councils' own resources (i.e. council tax).

30. The underpinning formula will next be subjected to review in time for the 2011-12 settlement onwards. The current work schedule of the Settlement Working Group indicates that there will be changes to the highway maintenance, fire, police, environmental protective and cultural and capital financing formulae. There is also likely to be a review of area cost adjustment calculations and a discussion and debate on the availability and thus scope for inclusion or otherwise of 2011 Census data. We can expect formal consultation on any changes to begin in 2010.

Education Funding and Dedicated Schools Grant

31. The DfES (now the Department for Children, Schools and Families) launched its five-year strategy for Children and Learners in July 2004, which set out key reforms including guaranteed three-year budgets for every school from 2006, tied to the CSR cycle and geared to pupil numbers, with every school also guaranteed a minimum per pupil increase each year. The DfES introduced this funding mechanism in the form of Dedicated Schools Grant in 2006-07. Indicative funding was announced for 2006-07 and 2007-08. A consultation took place in early 2007 about potential changes to this funding system for the period 2008-11 and decisions on that were announced on 25 June 2007.

32. Those announcements meant that the risks that we identified with the DSG system when it was introduced will continue in the future. Decisions on schools budgets will still have to be

taken before DCSF announce the final DSG, due to lags in the DCSF systems for processing and verifying pupil data. Local decisions therefore have to be based on indicative allocations with a mechanism to deal with under and over allocations.

33. The announcements do not change the fact that the funding arrangements seem to be based on an assumption that there is a national “one size fits all” solution to the funding of schools. The new system leaves little room for changes to reflect local needs and priorities. It also assumes that at the point in time that these changes were introduced the local schools formula was “right”.

34. There are immense pressures from Government stated commitments and priorities and there is estimated to be an excess pressure on DSG funded services and no funding headroom to pay for this. The only option to close the gap other than cutting services would be to top up funding from council tax. But with funding pressures of our own it is wholly unacceptable to expect local taxpayers to top up a supposedly nationally funded schools service.

35. Given that there is also an expectation by Government that there will be further expansion of the Academies programme it is worth noting that each academy that opens takes further resource away from the DSG grant settlement for the authority which will impact on the funding of both CFE and CED.

36. The overall impact of these changes has meant that the supposed headroom that the authority has (which is the difference between overall DSG funding increases and the amounts that have to be passported to schools and schools spending under the funding guarantee) may well become negative.

37. The decisions about the future funding framework that were announced in June 2007 include some significant longer term changes in respect of funding for schools and early years. Subsequent announcements have made it clear that by 2010 all funding for 16-19 year old students in schools and FE Colleges will be removed from the LSC and (partially) returned to local authorities through a new grant that is separate to, but “aligned” with, the DSG. There will also be two new national funding bodies to replace the LSC in respect of schools and FE colleges. A DCSF/DIUIS consultation on a range of proposals as to how all this might work took place earlier this year and we understand that Ministers will be taking final decisions on this by October 2008. The DCSF clearly wish to retain a national formula for 16-19 funding and have raised the possibility of extending this to 14-16 in 2011/12. By April 2010 we have to have established a single local formula for all early years funding (maintained and PVI). By 2011-12 there should have been a wider review of the national methodology for DSG distribution to local authorities, from which a single formula for all should be announced. This could adversely affect Kent.

38. For KCC, there is a further particular concern in relation to the funding of those parts of the DSG that cover Early Years and non-delegated items such as spending on the Education Welfare Officers (EWOs), Attendance & Behaviour Services, Pupil Referral Units etc. As a first call the DSG must fund the nationally set minimum per pupil increases in schools (the minimum funding guarantee), which means that the resources available in the DSG for the other services such as these may be squeezed to unacceptable levels. This is particularly an issue in terms of the early years funding for the PVI sectors where the DCSF announcements have built up a degree of expectation about improved funding despite the fact that there are no indications about any extra money being made available in the DSG.

39. There are continuing worrying issues in relation to new responsibilities and pressures for schools. Schools are having to make efficiency savings in order to balance their budgets because of the impact of falling rolls. Alongside this there is the concern that there are no

national mechanisms in place to reflect significant local pressures on schools – such as the big price increases schools face when long-tem contracts for services such as energy, catering and cleaning come up for renewal – apart from squeezing that element of the DSG that funds other local authority services for schools and pupils. It was this failure to properly assess the costs that led to the national funding "crisis" in 2003 and this is already being reflected in the 3 year budget plans produced by schools in May/June 2008 which shows an increasing number expecting to move into a deficit position during the period 2008-11.

Forthcoming legislative change and consequential pressures on local government

40. There are, as ever, a number of proposed government bills, as set out in the draft legislative programme in May 2008, which will have direct or consequential affects on local government.

41. The Community Empowerment, Housing and Economic Regeneration Bill implements those elements of the recent Empowerment White Paper requiring primary legislation, implements the recommendations from the review of sub-national economic development and regeneration and extends the powers of the new social housing regulator. The bill provides increased opportunities for local communities to be involved in decision taking, including giving individuals the right of response to petitions.

42. The National Health Service Reform Bill takes forward the recommendations of the Darzi review of the NHS and includes measures for increasing accountability to local people.

43. The Policing and Crime Reduction Bill increases accountability in the police force and seeks to establish a public voice in decision making through directly elected representatives.

44. The Education and Skills Bill seeks to promote excellence in schools, modernises the apprenticeship system and transfers funding responsibility for delivering 16-18 education and training to local authorities.

45. The Business Rates Supplement Bill will give county councils and unitary authorities the power to levy a local supplement of up to 2p per pound of rateable value on the business rate and retain the proceeds for economic development subject to a majority vote by local businesses.

46. The Coroners and Death Certification Bill will create a national coroners service with minimum national standards but crucially there will remain a funding anomaly, as funding responsibility will remain with local authorities and the cost of the service will continue to be an issue (e.g. the costs of large scale inquests which are outside individual council control)

47. Other bills of relevance to local government include:

- Welfare Reform Bill
- Equality Bill
- Constitutional Renewal Bill
- Citizenship, Immigration and Borders Bill
- Marine and Costal Access Bill
- Heritage Protection Bill

National Spending Pressures

48. CSR 07 set out, as expected, a much tighter public spending round than we have seen for the past decade. That was predicated on assumptions made by the government at the time

before the full impact of the "credit crunch" was known and before the rapid and accelerating increases in commodity prices which have begun to spill over into the wider measures of inflation. This has been coupled with noticeably slowing economic growth which will in turn affect future tax revenues for the government.

49. It is fair to say therefore that what was assumed at the time of CSR 07, and the basis for the spending plans to 2011, is already significantly out of date. What was already a significant tightening of expenditure is likely to become tighter still.

50. Particular additional challenges remain in funding and tackling climate change, growing fuel poverty, waste and its disposal, and increases in the old age dependency ratio and for the latter particularly how the long term funding for older people is to be put on a sustainable funding footing. Nevertheless there is very little, if any room, for manoeuvre by government to put any additional funding into these areas.

Local Government Pension Scheme

51. The regulatory framework for the new LGPS scheme came into effect from 1st April 2008.

52. To address the general trend of increased life expectancy (and therefore pensioners claiming their pension for longer), the new scheme aimed to make the LGPS more affordable and sustainable. Removing the 85 year rule, those who retire under 65 will receive slightly less, where those who retire later receive the full benefits. It is however, payable for a longer period for all involved, because of increased life expectancy, continuing the overall strain on the pension fund.

53. On average, employers pay in twice as much as employees do - meaning this will also be payable for longer. The Government wanted to ensure no additional costs were imposed on the taxpayer, so plans are to be in place by March 2009 to have a mechanism of sharing future costs pressures. The actuarial valuation of the new scheme will not be until 2010, and individual fund actuaries will set new employer contribution rates to take effect on 1 April 2011.

54. On balance, though, there appears to be some additional upward pressure on employer contribution rates to come, due to longevity, despite good investment performance.

Interaction of services with the NHS

55. There is a continued grey area between the NHS and local authorities in the responsibility for provision of some aspects of health and social care. The well documented and reported upon funding crises affecting aspects of the NHS are beginning to be felt by local authorities. KCC is no exception to this pattern.

56. The LGA last year published a report following a study of local authorities operating in areas where NHS trusts are in deficit. Returns were received from 55 of the 78 local authorities in those deficit areas. Of these, 67% indicated that the deficit had had an adverse effect on the authority. It demonstrates that trusts have adopted a number of cost-cutting measures that have impacted on councils, including:

- The withdrawal of funding from jointly funded projects
- A sharp increase in the referral of patients that would normally be cared for by the NHS
- Paying no more than one per cent inflation on existing joint contracts
- Closure of beds

57. Measures local authorities have adopted to cope with the cutbacks have included:

- Withdrawing services from people with lower-level care needs
- Increasing waiting times for social care assessments and services
- Outsourcing more services
- Transferring resources from other services – including leisure facilities and transport
- Using budget reserves
- Negotiating with – or taking legal action against – the NHS over the non-payment of bills

58. The Audit Commission has reviewed several aspects of the funding of the Health service, and published three reports, all of which have a bearing on this. The main themes identified were:

- The increasing severity of the deficits, and the concomitant difficulties of recovering from these
- The needs for appropriate skills, leadership and cultures to be developed within the NHS organisations
- The importance of a robust financial management framework to support radical service configurations, where these are deemed to be necessary

59. The position in Kent is that the Health economy experiences substantial and significant difference between East and West Kent Primary care trusts. The West Kent PCT is in financial deficit and the east Kent PCT in financial surplus and this has consequential knock on effects on their respective ability to offer broadly the same levels of support and care to Kent residents.

60. Managers are working carefully to ensure that the risks and uncertainties arising from the difficult financial environment do not impact on services or service users. The budgetary risk is also being carefully monitored; and where appropriate Health decisions are being challenged. There will continue to be risk for the council's social care services all the time that the Health economy locally is so stretched at a time when demographic trends mean that there will continue to be large scale funding pressures on funding elder care. However, it is also clear that there can be no resolution to this difficulty unless the council is constructively engaged.

61. In order for local Councils to take greater share of responsibility in public health and health services, central Government has abolished the Patient and Public Involvement Forums and the Commission for Patient and Public Involvement in Health. They have been replaced by the Local Involvement Networks (LINKs). The prime function will be to gather information and make the views of the public know about local health and social care services.

62. We are supplementing national provisions with our own stronger local accountability arrangements by setting up and funding Healthwatch.

Differences across the UK

63 It is also perhaps worth noting and contrasting the different funding levels that exist between England, Wales, Scotland and Northern Ireland at a time when the balance of funding is being reviewed. The Barnett Formula, which was introduced in the seventies, and has not been reviewed since, results in substantially more public spending in these countries than in England. It is time that the formula was reviewed to see if it still accurately reflects relative needs.

Table 1 - Public expenditure by region/country

Country/Region	Spend £ per head of population 2007-08 plans
England	7,535
Of which South East	6,512
Scotland	9,179
Wales	8,577
Northern Ireland	9,789

(Source: HM Treasury: Public Expenditure Statistical Analysis, 2008 table 9.2)

64 The government expects council taxpayers in the South East, excluding London, to bear a much higher proportion of spending than in other regions, particularly in the North and Midlands. Table 2 shows that the proportion of spending borne by the council taxpayer is around 54% in the South East in 2007-08, but around 42% in the North East and under 40% in the East Midlands.

Table 2 – Funding, Grant and Council Tax in 2008-09

Region	Proportion of Budget Requirement met by council tax %	Grant increase %	Increase in Band D for all tiers %	Average council tax per dwelling £
Kent	**48.3**	**3.4**	**4.1**	**1,259.63**
South East	**54.2**	**2.5**	**4.4**	**1,309.20**
South West	55.1	4.1	4.5	1,208.87
Eastern	47.0	3.5	4.4	1,235.74
East Midlands	39.7	5.2	5.3	1,091.95
West Midlands	41.0	4.2	3.8	1,060.17
Yorkshire & Humber	45.0	4.2	3.9	998.67
North West	42.3	3.8	3.7	1,039.33
North East	42.0	3.2	3.5	1,004.20
London	41.6	2.3	2.7	1,198.89
England	44.4	3.5	4.0	1,145.79

Source: Communities 2008-09 Settlement data; CIPFA council tax statistics 2008-09

Capping

65 KCC and the LGA are both opposed to capping. Ministers have reiterated that the government is prepared to use its capping powers to protect council-tax payers from excessive increases where necessary.

66 Ministers have indicated that increases in excess of 5% will be subject to scrutiny and run the risk of capping.

67 For 2008-09 eight authorities were deemed to have set excessive council tax increases (defined as a budget requirement increase of 5% or more between 2007-08 and 2008-09 and a council tax increase of more than 5% in the same period).

68 Lincolnshire Police Authority was designated for capping. Three other police authorities were allowed to retain 2008-09 council tax increases but had restrictions imposed limiting future year increases to 3% for 2009-10 and 2010-11, a variant of being designated for capping. Three further police authorities and one unitary council, Portsmouth, had

alternative notional budgets set for 2008-09 allowing them to keep 2008-09 budgets and council tax levels unchanged from those proposed but limiting their scope for future council tax increases.

Provisional settlement 2009-10 to 2010-11

69. Due to the CSR 07 announcement last autumn and the consequential three year provisional local government finance settlement we already know our provisional grant allocations for both 2009-10 and 2010-11.

70. It is assumed, as government intends, for these to be firm settlement figures but there will, as is usual, be a period of consultation on each year's actual settlement to enable representations to be made if material errors or omissions are discovered in the calculations.

71. Tables 3 and 4 set out are provisional settlement for 2009-10 and 2010-11.

Table 3 – Provisional Settlement for KCC 2009-10

	Adjusted Base 2008-09 £m	**Provisional Settlement 2009-10 £m**	**Increase for KCC £m**	**Increase for KCC %**
Relative Needs	n/a	276.5	n/a	n/a
Relative Resource	n/a	-170.6	n/a	n/a
Central Allocation	n/a	171.4	n/a	n/a
Floor Damping	n/a	-10.1	n/a	n/a
External Funding (Revenue Support Grant and NNDR)	258.9	267.2	8.3	3.2%*

* After adjusting for loss of LABGI grant, this falls to an effective 2.0% for 2009-10

Table 4 – Provisional Settlement for KCC 2010-11

	Adjusted Base 2009-10 £m	**Provisional Settlement 2010-11 £m**	**Increase for KCC £m**	**Increase for KCC %**
Relative Needs	n/a	284.4	n/a	n/a
Relative Resource	n/a	-176.4	n/a	n/a
Central Allocation	n/a	179.5	n/a	n/a
Floor Damping	n/a	-11.8	n/a	n/a
External Funding (Revenue Support Grant and NNDR)	267.1	275.7	8.7	3.2%

72. Table 5 sets out some examples of the settlements to show the wide disparity between regions and authorities.

Table 5 - Increase in Grant – Some Examples

	Increase in grant on like for like basis			
	2007-08	**2008-09**	**2009-10**	**2010-11**
England	3.8%	3.5%	2.8%	2.6%
East Midlands Region	4.5%	5.2%	3.9%	3.6%
South West Region	4.3%	4.1%	3.4%	3.3%
London	3.4%	2.3%	2.1%	2.0%
South East Region	**3.4%**	**2.5%**	**2.2%**	**2.2%**
Shire Counties (average)	3.8%	5.3%	4.2%	4.0%
Dorset	9.5%	10.9%	7.6%	7.1%
Norfolk	8.4%	8.7%	6.0%	5.3%
North Yorkshire	5.9%	6.3%	5.2%	5.2%
Kent	**2.7%**	**3.4%**	**3.2%**	**3.2%**
Sample Kent Districts:				
Swale	8.0%	1.7%	1.3%	1.1%
Canterbury	5.2%	2.9%	2.8%	2.5%
Thanet	2.9%	1.5%	1.1%	1.1%
All others	2.7%	1.0%-1.6%	0.5%-1.8%	0.5%-2.5%

KCC Input to the next Spending Review

73. KCC lobbied comprehensively ahead of CSR 07 and produced a document *Input into Comprehensive Spending Review 2007*, which provided information about the shortfall in funding that Kent suffers. This was submitted to HM Treasury on 26 May 2006.

74. We believe KCC has been under-resourced for some time and the next spending review in either 2009 or 2010 is the appropriate juncture for the Government to take stock of resource allocation.

75. Likely key issues for KCC for the next spending review are set out in Appendix 2.

Local Area Agreements and Local Public Service Agreement 2

76. The first Local Area Agreement between Kent County Council, working with the Kent Partnership and other local partners, and the Government concluded at the end of March 2008, although it will take some time to ratify and verify the performance achieved in some of the performance indicators. The agreement comprised a set of 18 outcomes which been developed and agreed by a very wide range of partners across Kent.

77. The Local Public Services Agreement 2 (LPSA2) was developed alongside the LAA and all of the LPSA 2 targets contribute to the LAA. The total amount available on successful conclusion of all targets in LPSA2 is in the region of £36 million for all Kent partners. We continue to estimate KCC and its partners are likely to receive in the order of £23 million based on our performance. £16 million of this is estimated to flow to KCC although a prudent 50% of this amount has already been built into our cash limits. Payment by way of performance reward grant will be made at the end of 2008-09 and the end of 2009-10.

78. We have recently concluded with government and partners negotiations for the second local area agreement. This focuses on 35 agreed indicators and a further series of statutory education indicators. This agreement is also subject to the payment of performance reward grant although the amounts potentially payable are around one fifth of those payable last time round. Any payments of PRG will be made in 2011-12 and 2012-13.

The Efficiency Agenda

79. Alongside CSR 2007, DCLG published a value for money plan for the CSR period. All public services have now been set a target of achieving at least 3% net cash-releasing value for money gains per annum over 2008-09 to 2010-11. This target excludes schools expenditure with a target of 1%. The rationale for a substantially lower efficiency requirement from schools has not been adequately explained by government, although with many schools having 80% plus of their budget committed to staffing, perhaps this is the reason.

80. The annual efficiency target for each of years 2008-11 is £28.2 million.

81. KCC has recently submitted its final Annual Efficiency Statement for the period covered by Spending Review 2004 and the Gershon Report. We have achieved just under £90 million of total cumulative efficiency gains, of which just over £74 million are cashable. KCC has the potential to carry forward its overachievement of efficiency gain for this review period to the new efficiency period spanning 2008-11. The amount that might be able to be carried forward is just over £22 million.

82. The drive for efficiencies and savings is not a new one for KCC. Savings in the published budgets of KCC amount to a cumulative £211.0 million between 2000-01 and 2008-09. Our actual level of efficiencies far exceeds even this value as services continually provide more/better services for the same price.

Comprehensive Performance Assessment

83. In February 2008, it was announced that the KCC had achieved the highest 4 star rating for its annual CPA for the sixth year running, and that its direction of travel is 'improving strongly'.

84. Only one other county council was rated four star, judged to be 'improving strongly', and awarded the highest mark for both its use of resources and its corporate assessment. Of the two county councils we had the lowest Band D Council Tax.

85. Between 27 November 2007 and 9 May 2008 KCC has been subject to a new corporate assessment (the last being in 2002) which forms part of the overall CPA score. KCC has been awarded the highest possible score of 4 out of 4 for its Corporate Assessment having been assessed across five themes; ambition, prioritisation, capacity, performance management and achievement

86. The new Comprehensive Area Assessment will take place in 2009. This will encompass an Organisational Assessment (of KCC) scoring how well performance is managed and resources are utilised and an Area Assessment which looks at the prospects for future improvement in the whole of Kent as an area (i.e. taking into account what KCC and its partners do and plan to do).

Growth Agenda

87. KCC's medium term planning needs to be seen in the context of Kent's housing growth and consequent wider infrastructure and investment needs. This is set out in "What Price Growth". The scale of development being sought by the Government will affect the whole of Kent and pose a huge financial challenge over the next 20 years. The Government has still not yet fully recognised the scale of the investment in local services required by its plans for housing development in the South East. Proposals currently progressing through

Parliament for the Community Infrastructure Levy which will give local authorities a power, but not obligation, to levy a charge relating to new developments having due regard to the scale and character of the development are at least a start but in providing for that levy to flow to lower tier councils fully fail to have due regard to the strategic capacity, delivery and indeed obligations of upper tier authorities such as KCC.

88. KCC has been working with partners to assess the investment contribution that will be needed in the wider public sector to meet the scale of the growth in the county. We have developed models to assist in this assessment of our investment needs and the revenue impact of that investment. It is this context that we will continue to be urging the government that data on population numbers should be projected where possible for growth areas, and that any time lags should be avoided if at all possible.

89. The County Council will work together with the Government and across the public sector to maximise funding streams from other investment sources such as PFI and PPP where these offer value for money, as well as exploring Kent retaining a proportion of the additional business rates generated by new commercial development.

90. KCC's decisions on our Medium Term Capital Programme must be weighed against the scale of the Government's continuing support for borrowing and grant funding, the new prudential borrowing regimes, and the County Council's total borrowing and our ability to service this through revenue funding.

91. Some specific service issues affect authorities such as KCC. The shortage of land in the South East affects waste management costs, through higher capital costs of new facilities for recycling and incineration, as well as landfill.

Financial Planning Risks

92. All our resourcing and spending assumptions are based on the Government's expressed views about levels of council tax, increases in government grant and funding for Kent schools.

93. This year whilst we have reasonable certainty over our funding levels for 2009-10 and 2010-11 we face considerable uncertainty over our spending pressures both for next year and the following few years. We have the following to take into account:

- The continuing impact of the credit crunch, including a potential reduction in client incomes and wealth and thus our ability to charge for services
- Substantial increases in inflation for the goods and services we purchase
- Greater potential demand for our services as the economy slows
- Continuing demographic trends (rising elderly population)
- On-going risk of not recovering costs of supporting Asylum Seekers
- The key individual service risks built into our risk registers.

94. There is uncertainty over the burdens that may be imposed upon local government by a number of new bills before parliament:

- Community Empowerment, Housing and Economic Regeneration Bill
- National Health Service Reform Bill
- Policing and Crime Reduction Bill
- Education and Skills Bill
- Business Rates Supplement Bill
- Welfare Reform Bill

- Equality Bill
- Constitutional Renewal Bill
- Citizenship, Immigration and Borders Bill
- Marine and Costal Access Bill
- Heritage Protection Bill
- Coroners and Death Certification Bill

95. There is a risk to the LABGI scheme. KCC has argued the current scheme is not operating as it should do. Other authorities, with specific issues, have gone further and sought judicial review of the government's operation of the scheme. On 31 July 2007, two councils won their judicial review that the government had not operated the scheme correctly. Government has reworked the LABGI scheme but held back £100 million of the reward earnt by local government in case there are further legal challenges to its operation of the existing scheme. We still await details of how the new, much smaller value, scheme will operate.

96. Our key assumptions on the budget and medium term plan for the County Council are therefore:

- 3.2% formula grant increase for each of the next two years (although net of LABGI losses this is worth an effective 2.0% in 2009-10) given the pre-announced provisional local government finance settlement;
- Approximately 1% reduction in cash terms each year for Area Based Grant on like for like basis as some initial start up grants cease (Area Based Grant will increase by approximately £32m in 2009-10 to allow for the transfer of Supporting People grant into ABG – but this is merely a transfer and not new money);
- Specific grants (which are increasingly primarily targeted at education and children's services and of course ring-fenced) increase as set out in the three year local government finance settlement (e.g. DSG headline increases of 3.4% for 2009-10, 4.1% for 2010-11, Sure Start, Early years and Childcare headline increases of 10.6% for 2009-10 and 13.9% for 2010-11);
- 5% maximum increase in council tax per annum given the threat of capping but equally a desire to keep actual council tax increases as low as practicable;
- Council Taxbase grows by 1% per annum;
- That there is no deterioration beyond that already provided for in the collection fund as the housing market stalls;
- A limit on pay having due regard to the Chancellor of the Exchequer's stipulation to all pay review bodes that public sector pay increases must be contained within a 2% limit;
- That specific grant changes and risks do not adversely move against us, but if they do and funding is directly reduced, we will have no option but to reduce services;
- That Dedicated Schools Grant is sufficient to meet all government promises on service extension and minimum funding guarantees;
- That costs of asylum seekers are fully met and reimbursed by government;
- That we have fully captured updated pressures on our services (pay, prices, demographics, demand, legislation, impact of "credit crunch");
- That we deliver significant efficiencies and savings in specific services and through a series of cross cutting reviews of services.

97. Taking these assumptions we anticipate that the overall budget position will be as follows

	2009-10	2010-11	2011-12
	£'000	**£'000**	**£'000**
Base budget	857,018	930,308	968,831
Base adjustments	38,534	48	17
Pressures (see Appendix 2)	85,598	73,730	62,635
Savings and Income Generation	-50,842	-35,255	-33,318
Budget Requirement	**930,308**	**968,831**	**998,165**

98. Cash limits for individual portfolios will be set having due regard to our policy priorities. Our priorities will have due regard to spending pressures, demographic change, legislative imposition and local choice. The indicative pressures summarised in appendix 3 will be scrutinised, in detail, very closely as we go through the budget process. There will inevitably be changes to this as that process develops.

99. Part of that iterative process will of course be involving, and informed by the work of, the Policy Overview Committees in both November and January and Cabinet Scrutiny Committee in January. It is intended as part of the November POC cycle to further strengthen and build upon the information that POCs receive to help them shape, influence and inform the discussion and debate of aligning resources to priorities. That will include for the first time some explicit activity costing so that POCs are able to see the trade-offs and linkages between outcomes, volumes of activity and levels of budget. Or put simply, ensuring that appropriate information is supplied that expresses, for example, the cost per additional elderly person needing residential care, the cost per extra km of road resurfaced, the cost per average library etc. so that there is a clear and explicit link on a "ready reckoner" basis between current activity volumes and proposed budget and how those budgets would change if activity volumes were to change or be redirected to other policy priorities.

100. The overall scale of the gap between what we would wish to spend and what we are likely to be able to afford, and the consequential savings target, is likely to be consistent with achieving at least the overall 3%, government imposed Gershon target over the medium term.

Reserves

101. The Director of Finance is required to consider the adequacy of the authority's reserves as part of the budget process. Our existing strategy is to take a view about the balance of risk on our medium term financial plans in order that we maintain sufficient levels of reserves to meet such risks. It is our view that with £25.8m of general reserves (at 31 March 2008) this is achieved but will be reviewed, as normal, during the budget process.

Appendix 1 – Timetable

Key Milestone Dates

What	***Who***	***When***
Autumn Budget Statement	Cabinet	15 September
Opportunity for Cabinet Scrutiny to consider Autumn Budget Statement	Cabinet Scrutiny Committee	24September
Public consultation on budget	Cabinet Member for finance, finance officers, MORI, district council representatives	13 September
Review of budget proposals and overall pressures, impacting upon the relevant directorates	Policy Overview Committees	6-18 November
Provisional Settlement – announcement by government and then analysis and interpretation for impact for KCC 2008-11	Financial Strategy Group – briefing for all members	Late November / early December (*timing not yet announced by government)*
Update on Provisional Settlement and review of corporate budget strategy (if announced - see above entry)	Cabinet	1 December
Chancellor of Exchequer Pre-Budget Report	Financial Strategy Group	December (*timing not yet announced by government)*
Budget proposals published and press conference	Cabinet	5 January
Review of budget proposals and overall pressures, impacting upon the relevant directorates	Policy Overview Committees	13-20 January
Final settlement for 2009-10	Cabinet	Late January/ early February (*timing not yet announced by government)*
Opportunity for Cabinet Scrutiny to consider proposed budget	Cabinet Scrutiny Committee	26 January
Cabinet recommends budget to Council	Cabinet	2 February
Council sets budget and precept	Council	19 February

Appendix 2– Key pressures

Demographics (inc. Elderly)	Rising elderly population nationally/locally More complex needs (and costs) across all ages Existing funding inadequate/ unsustainable Risk of increasing numbers of 'wealth depleters' triggering more and sooner LA funding if house prices drop significantly Social Care Funding Reform (who pays and when likely implemented? What happens in between) More investment in preventative care (e.g. Telecare, Telehealth) Aim has to be to enable more people to live at home (for both cost and personal fulfilment) Leading healthy, active, independent lives Ensuring the Census 2011 adequately captures the national and local changes to demographics
Young people	A desire to ensure every child to reach their full potential Tackling/eradicating child poverty Investment needed in preventative services to lift out of poverty, crime, truancy, engrained lifelong under-achievement etc. Inadequate funding for young people services outside of Dedicated Schools Grant Inadequate funding for the 10 year Child Care strategy 14-19 Agenda (cost of reform, service delivery etc.) Ensuring full reimbursement of cost of asylum seeking unaccompanied minors Non-sustainability of Dedicated Schools Grant in medium-term, funding barely pays for teacher pay award, rising numbers of schools in deficit etc. Sustainability or otherwise of Building Schools for the Future funding Inflation – transport costs for HTST, foster care
Environment	Continuing impact of EU Landfill Directive Landfill tax currently rising by £8 a tonne a year Need for the tax to be fully and transparently recycled (as was promised) Compounded by Landfill Allowance Scheme and £150 a tonne if landfill exceeds permit Affluence has grown waste volumes Supply shortage of alternative facilities means higher cost of procuring alternatives to deal with waste High fuel prices impact on transport costs of disposal Carbon Reduction Commitment £12 a tonne for permits A new cost burden on local authorities plus a need for full and transparent recycling of permit fees (as promised)
Transport	High fuel costs

	Impact on all users On bus subsidies (as fuel poverty inhibits car usage and increases demand for public transport) On concessionary fare scheme (extra demand, high cost of fuel pushes up operator prices, funding risks on proposed transfer from district to county level) Existing substantial road maintenance backlog Inflation on roads contracts currently high and likely to remain so Infrastructure investment needed especially in growth areas Volume of traffic through the county (especially HGV) as gateway to Europe
Community	Concerns over crime, disorder etc. The new Economic Development Obligation (Community Empowerment, Housing and Regeneration Bill) At a time of slowing economic activity nationally Reviving Coastal Towns Shortage of social housing, exacerbated by economic downturn (LGA 5 million people on waiting list by 2010?) Deprivation - Kent's mixed economy Growth - 2 of 4 national areas in Kent Sustainability - Climate change, water shortages, flooding
Cost Drivers	Geography - Gateway to Europe, proximity to London and effect on prices and wages Inflation - Outlook is higher for longer, puts funding pressure on all our services Pay - Consequential knock on pay awards and on sustainability of 2% target
Funding	Efficiency - Unsustainable to just assume 3% for everyone for ever, ignoring starting point for each council Bonfire of quangos - Allow us to do more locally, as efficiently as we already do and the public sector will save money – local government is the most efficient Formula Grant - We need transparency, stability, predictability, responsiveness to growth agenda etc. to be addressed in the next review of formula funding Ring fencing - End ring fencing, avoid double top ups for deprivation by currently targeting only to deprived areas Full funding - respect and follow the New Burdens Doctrine Barnett Formula - Scrap the formula and fund all according to relative need Business rates - Return to local control, Supplementary Business Rates, proper LABGI scheme Council Tax - Don't allow all unfunded burdens (shortfall in grants, cap on business rate increases) to unduly burden council taxpayers as already at limits of ability/willingness to pay Capping - Scrap universal capping Pensions - As we predicted the new scheme does nothing to address affordability in long run of LGPS – we need proper thought out costed reforms

	Credit crunch - Impact on ability to finance capital spend, on PFI schemes etc Olympics - Impact on supply, inflation, infrastructure costs
Empowerment	Devolve - trust local government to do more Burdens imposed by Community Empowerment, Housing and Regeneration Bill (potential right for public to redirect spending, force a debate etc.) Freedom to trade - Greater clarification, there are powers and we use them but we are often challenged at cutting edge about what we are doing - clarify the position More freedoms and flexibilities required

Appendix 3 – Indicative Pressures

	2009-10	2010-11	2011-12
	£'000	£'000	£'000
Existing pressures			
Pay	7,432	7,532	0
Prices	15,240	15,503	0
Government/Legislative	3,545	9,251	0
Demand/Demographic	8,217	7,739	0
Towards 2010	6,250	200	0
Schools Budget	23,442	28,938	0
Dedicated Schools Grant Increase	-27,930	-39,125	0
Service Strategies and Improvements	19,877	21,698	0
Sub-total	**56,073**	**51,736**	**0**
Major new pressures			
Pay – minor adjustments	53	69	0
Prices – reflecting higher fuel, food and general inflation	14,895	10,307	0
Government – Early Years pressures, Looked After Children Pledge, Common Assessment Framework, Children and Young Persons Bill	8,809	1,281	0
Demand –Early Years, Childrens Social Services, Adults Social Services	13,398	1,921	0
Schools block – net price pressures after taking account of DSG grant changes	601	1,489	0
Service Strategies and Improvements – local children's service partnerships, investments into Kent Highways services, 2012 preparations etc.	4,956	-858	0
Pay new year provision			7,733
Prices new year provision			26,246
Legislative new year provision			2,047
Demand new year provision			8,653
Towards 2010 new provision			200
Choice new provision			1,700
Schools Block new year provision			34,999
DSG new year provision			-35,728
Less new pressures shown that would otherwise fall on DSG - all pressures resisted	-13,187	-2,215	-3,215
Expected pressures to emerge - not yet fully identified		10,000	20,000
Total pressures	**85,598**	**73,730**	**62,635**

	2009-10	2010-11	2011-12
	£'000	£'000	£'000
Pressures by portfolio			
Operations, Resources and Skills	10,455	5,985	6,142
Children, Families and Educational Achievement	19,006	3,879	2,743
Less new pressures shown that would otherwise fall on DSG - all pressures resisted	-13,187	-2,215	-3,215
Adult Services	25,498	23,746	23,913
Environment, Highways and Waste	19,007	8,310	8,249
Regeneration and Supporting Independence	383	-40	69
Communities	2,327	1,889	1,512
Public Health	53	3	3
Corporate Support and External Affairs	1,682	2,211	2,592
Policy and Performance	227	185	138
Finance	2,063	1,761	489
Financing	18,084	18,016	0
Expected pressures to emerge - not yet fully identified		10,000	20,000
Total pressures	**85,598**	**73,730**	**62,635**